TAXbit

A Guide to Tax Compliance for Digital Platforms

Modern Tax Compliance, Simplified

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Introduction

Over the past decade, digital platform businesses (specifically gig, creator and marketplace platforms), have grown to capitalize trillions of dollars worth of value. It is no surprise that along with this rise we have seen a shift across the traditional office workplace setting. Working at a digital platform company offers flexibility, variety of tasks, no "boss", yet solid wage earning potential. The Covid-19 pandemic also had a significant impact on the shift in the overall traditional employment setting, and helped to grow the desirability of working within the digital platform and gig economy space.

This new employment setting does bring a unique challenge to workers - how to properly track their income, file accurate tax returns, and pay the corresponding taxes that are owed. While not an employee receiving a W-2, US independent contractors do receive a variety of information returns, including the Forms 1099-MISC, NEC and potentially the 1099-K. Understanding what these forms are for an independent contractor can be challenging for companies, yet is essential to accurately performing regulatory-required information reporting.

In February 2023, for example, the New York Times broadcasted the headline: *"They Went Viral and Made Money. Now They Owe Taxes.* Many content creators who earned money for the first time on platforms like TikTok, Instagram and YouTube are figuring out what a 1099 form is and what they can write off."

This whitepaper will break down the basis of information reporting for non-employees, and will also look at the regulatory changes in the US and EU that will further impact digital platform enterprises, and help to prepare your business well ahead of tax season.

Common digital platform US information returns & issues encountered

The most common information returns filed by US businesses operating as digital platforms such as payment platforms, gig economy companies, creator platforms, and the like are listed below:

1099-K: Reports gross sales to sellers or merchants. As discussed in further detail below, the threshold for Tax Year 2022 remained at sales of more than $20,000 with 200 or more total transactions. The threshold for Tax Year 2023 is $600 in gross sales. If there is any backup withholding that is applicable to the payment, a 1099-K is required regardless of the gross sale threshold.

1099-MISC: Reports miscellaneous income to users (such as for royalties, prizes/awards, legal settlements, and other income).

1099-NEC: Reports non-employee compensation over $600 (i.e. earrings and proceeds other than wages, salaries and tips) to US persons providing services as independent contractors.

Irrespective of the type of 1099 your company is required to file in the US, it is important that there are rigorous customer onboarding procedures to classify the recipient of the payment, capture the necessary information required for tax compliance such as the recipient's name, address, and Tax ID. Within the US, it is an industry best practice to collect that information on a Form W-9 or W-8.

Beyond the US regulations, digital platforms will now also face similar compliance challenges and requirements if a EU resident or operating within the EU. This whitepaper will help educate digital platforms for the upcoming DAC7 obligations that digital platforms will encounter in 2023/2024.

Regulatory Changes in the US & EU

1099-K reporting changes

The <u>American Rescue Plan Act of 2021</u> significantly lowers the threshold for tax information reporting for merchants via a Form 1099-K. The original effective date for the lowered threshold was tax year 2022. However, in December 2022, the <u>IRS issued Notice 2023-10</u>, delaying the implementation of the 1099-K reporting threshold and transaction limit change until 2023. The reason cited for the delay was to allow additional time for companies to prepare and comply.

Original

Gross Payments that exceed $20,000, and more than 200 such transactions

"Future" 1099K

Gross payments that exceed $600, regardless of the number of transactions

Additionally, many states have already lowered the threshold for gross earnings and have removed the minimum transaction requirement:

Arkansas:
$2,500 or more

California:
$600 or more

District of Columbia:
$600 or more

Illinois:
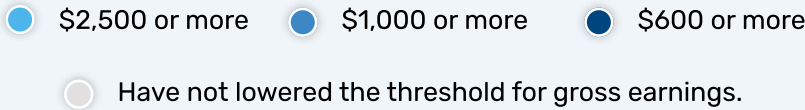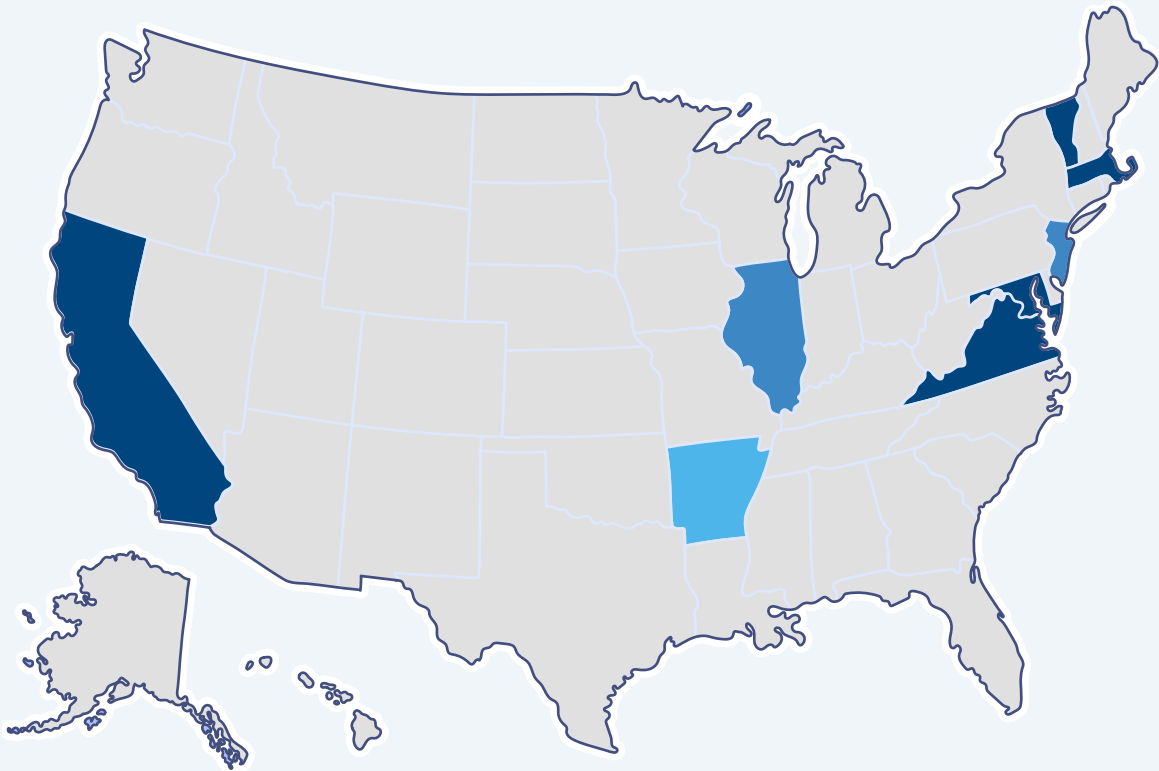$1,000 or more
(must have 4 or more separate transactions)

Maryland:
$600 or more

New Jersey:
$1,000 or more

Massachusetts:
$600 or more

Vermont:
$600 or more

Virginia:
$600 or more

- $2,500 or more
- $1,000 or more
- $600 or more

Have not lowered the threshold for gross earnings.

DAC7 - The EU's Variation of 1099-K Reporting

To add further complexity, the Directive on Administrative Cooperation (DAC7), comes into effect for reporting in early 2024 (for tax year 2023), and is the European Union's directive aimed at enhancing global tax transparency for marketplace and gig economy platforms.

Under DAC7, digital platform operators that facilitate a relevant activity are subject to DAC7, requiring operators to report sellers or gig workers.

Relevant activities include the following:

Rental of immovable property

Personal services

Sale of goods

Rental of means of transportation

Information Reporting Industry Challenges

1099-K reporting challenges

While seemingly simple to understand, information reporting can become a complex web of data collection, maintenance, and downstream reporting. Unless your business has a thorough end to end information reporting process, ideally supported by products that assist in automation, information reporting can be a laborious and manual process – with high stakes for enterprise operations, regulatory compliance, and user experience.

The following is a list of common challenges enterprises face when performing 1099 reporting in the US:

1. Determining who the payment recipient is - understanding whether or not it is a US person is a critical first step. As mentioned above, it is a best practice to collect a Form W-9 to assist with that.

2. Collecting and maintaining accurate payment recipient data, including matching their US Tax Identification Number (TIN) with the IRS prior to 1099 submission.

3. Ensuring that no withholding is applicable to the payment, subject to deposit or reporting.

4. The extraction and manipulation of data required for import into 1099 software or for sharing with service providers.

5. The generation, review, and approval of Forms 1099 by internal tax experts at your company.

6. Filing of Forms 1099 with federal and state agencies, and facilitating the various delivery methods to payment recipients of their copy of the 1099.

DAC7 reporting challenges

Challenges enterprises face when performing DAC7 reporting in the EU can be particularly onerous depending on the scale of your operations. The requirements will be to determine who is reportable and what is reportable for digital platforms, with the latter being inclusive of collecting an extensive amount of information.

Who is Reportable
Digital platforms will need to determine a sellers tax residency in determining who is in scope for reporting. Currently, there is no prescribed manner of collecting this information or required documentation. The rules do indicate that platforms will need to collect this tax residency information by the end of each reporting year, which introduces a unique problem that platforms will need to address in terms of when they require this information - at onboarding or later in the customer lifecycle.

What is Reportable
Digital platforms and marketplaces will need to be prepared to collect and report extensive data to the relevant tax authorities including, but not limited to:

- Seller name, addresses, tax identification numbers and dates of birth

- VAT identification numbers

- Business registration numbers

- EU member state of residence

- Financial account identifier

- Number of activities and transactions

- Total consideration paid or credited per year

- Any taxes, commissions, or fees. In case the marketplace has withheld any funds each year

- The address and land registration number for each property listing

- The number of days each property was rented

- Address and land registration number of each property

The marketplace operator of the/ platform will be held responsible for the accuracy and reliability of the collected data.

Importance of Automation

To streamline, leading enterprises have embraced automation. They increasingly view technologies that identify, collect, and maintain clean and accurate data for information reporting as critical to operational confidence and cost-effective operations. The primary value that businesses are seeing with automation include accuracy, efficiency, timeliness and cost-effectiveness.

Accuracy: This is foundational as part of information reporting. By automating the collection, maintenance, and reporting with software the risk of human mistakes are reduced, ensuring the accuracy of information reported.
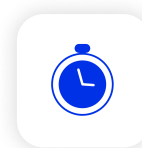
Timeliness: Tax Forms and statements have very strict deadlines, and while extensions can be available, it is important to ensure all filing deadlines are met.

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Efficiency: Tax reporting and compliance efforts involve gathering data from multiple sources, organizing, and scrubbing it prior to submission to the various tax authorities. Those efforts can be laborious and prone to human error. Utilizing software will help not only accuracy, but efficiency within the process.
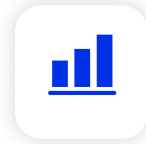
Cost-effectiveness: Manual and complicated processes require additional resources, especially as volumes rise, as they continue to do within the digital platform sector. Automation will allow for reduced manual intervention, dedicating those resources to other more value-add sectors of the business, which will result in an overall cost savings, and increased efficiency and usage of your workforce.

An industry-first automated solution

TaxBit's approach to tax compliance automates and integrates information collection and validation from onboarding to form generation, delivery, and filing - enabling our clients and their customers to stay compliant with an ever-changing regulatory landscape.

If you are interested in a scalable tax compliance solution that meets your digital platform needs contact us today!

For other inquiries or requests, including partnership opportunities, email info@taxbit.com.

Leading Enterprises Run on TaxBit

Enterprise Grade
Trusted by Fortune 500 and embraced by regulators

Modern User Experience
Real-time, role, and legal-entity-based access

Comprehensive
End-to-End platform from capture to validation to reporting

Powerful Insights
On-demand business and customer insights

Built by CPAs and Tax Attorneys
Leading-edge compliance and accuracy built-in

Security Focused
Independent annual audits and robust controls frameworks

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